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## Purpose

Use this publication (1) to determine if you need to make a California adjustment on Schedule CA (540 or 540NR) to account for the differences between California and federal law regarding Roth IRAs, (2) to figure the California basis in your IRA(s), if any, and (3) to figure the California adjustment if one is necessary.

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## What is a Roth IRA?

Beginning in 1998, regardless of your age, you may be able to establish and contribute to a new individual retirement plan called a Roth IRA. A Roth IRA is an individual retirement plan that, except as explained below, is subject to the rules that apply to a traditional IRA. It can be either an account or an annuity. To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is set up.

Unlike a traditional IRA, you cannot deduct contributions to a Roth IRA. But, if you satisfy the requirements, qualified distributions from a Roth IRA are tax free. Contributions can be made to your Roth IRA after you reach age 70½, and you can leave amounts in your Roth IRA as long as you live.

For more specific information regarding Roth IRAs (Contribution Limits, Conversions, Withdrawals, etc.), refer to federal Pub. 590, Individual Retirement Arrangements (Including Roth IRAs and Education IRAs). In general, California law conforms to federal law regarding the treatment of Roth IRAs, and, except as explained in this publication, you may follow the provisions explained in federal Pub. 590 for California purposes.

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## Why Are There Differences Between California and Federal Law Regarding Roth IRAs?

The Roth IRA was established by the federal Taxpayer Relief Act of 1997 (P.L. 105-34), and was effective for taxable years beginning on or after January 1, 1998.

California conforms to the federal Roth IRA provisions as established by the federal Taxpayer Relief Act of 1997. However, the federal Roth IRA provisions were later amended by the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (P.L. 105-206). California has not yet conformed to these amendments; therefore, until California does conform, there are differences between federal law and California law regarding Roth IRAs.

Legislation has been introduced in the California legislature, Senate Bill 93 (SB 93), that would conform California law regarding Roth IRAs to current federal Roth IRA provisions (including amendments made by the IRS Restructuring and Reform Act of 1998). As this publication goes to press, SB 93 (as amended on February 11, 1999) would be effective for taxable years beginning on or after January 1, 1998, and would make certain federal Roth IRA elections binding for California purposes. The elections affected are:

1. The election of a taxpayer to be taxed on 100% of the taxable amount of a rollover contribution made in 1998 from a traditional IRA to a Roth IRA (rather than to be taxed ratably over four years), and
2. The election of a surviving spouse to continue the deferral of income related to a 1998 rollover of a traditional IRA to a Roth IRA.

(If a taxpayer or surviving spouse made such an election for federal income tax purposes, the election would be binding for California purposes, and no separate California election would be allowed.)

Therefore, it is possible that legislation (SB 93) will be enacted to make California law regarding Roth IRAs the same as federal law as of January 1, 1998. If that occurs, the differences outlined in this publication will no longer apply. All Roth IRA transactions made since January 1, 1998 for federal purposes would be treated similarly for California purposes.

You may obtain information on the status of the Roth IRA conformity legislation (SB 93) through the following methods:

### By Internet:

<http://www.leginfo.ca.gov/index.html>

**By Phone:** Call (800) 338-0505, select general tax questions and enter code 213 when instructed.

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## Differences Between California and Federal Law

The following are the **current** differences between California and federal law regarding Roth IRAs:

### 1. Converting a Traditional IRA to a Roth IRA

#### Federal Law & California Law

You may convert amounts from a traditional IRA to a Roth IRA if, for the tax year you make the conversion, both of the following requirements are met:

1. Your federal modified adjusted gross income is not more than \$100,000, and
2. You are not a married individual filing a separate return.

The amount converted is includible in income (except for any amounts that were nondeductible when contributed to the traditional IRA) in the year of the conversion. However, if the conversion occurred in 1998, the amount of the conversion that is includible in income is included ratably over a four-year period, beginning with 1998.

**Election not to use the four-year spread.**

**Federal Law.** A taxpayer can elect to include the total amount in income in 1998 rather than over the four-year period. The election is made on federal Form 8606. If this election is made, it cannot be changed after the due date (including extensions) of the taxpayer's 1998 tax return.

**California Law.** As it currently conforms to the federal Taxpayer Relief Act of 1997, you may not make the election not to use the four-year spread. The amount that is includible in income from a 1998 conversion must be included ratably over four years. A taxpayer who made the federal election not to use the four-year spread for federal purposes still would be required to spread the income over four years for California purposes.

**Planning Note:** If you elected not to use the four-year period on your federal return and filed your California return (using the four-year spread), and California legislation is subsequently enacted that conforms California Roth IRA provisions to current federal Roth IRA provisions (as amended by the IRS Restructuring and Reform Act of 1998), you will

need to file an amended California return.

**2. Death of Roth IRA Owner During the Four-Year Period**

**Federal Law & California Law**

If a taxpayer makes a conversion from a regular IRA to a Roth IRA in 1998, the amount converted is includible in income ratably over the four-year period beginning with 1998. If a taxpayer who has made such a conversion dies before the fourth year of the four-year period, any amounts remaining to be included in income as a result of a 1998 conversion will be included in income on the final return of the deceased taxpayer.

**Election by surviving spouse beneficiary to continue deferral.**

**Federal Law.** If the surviving spouse is the sole beneficiary of the Roth IRA, the spouse may elect to include the remaining amounts in his or her income over the remainder of the four-year period. However, such an election may not be made or changed after the due date of the return for the spouse's tax year which includes the date of death of the Roth IRA owner.

**California Law.** As it currently conforms to the federal Taxpayer Relief Act of 1997, California law does not allow an election by a surviving spouse beneficiary to continue the deferral of income over the four-year spread. Therefore, for California purposes, a surviving spouse who makes the election to continue the deferral for federal purposes must still report all of the remaining deferred income in the tax year

of the IRA owner's death on the decedent's return.

**Planning Note:** You will need to file amended returns if you are a surviving spouse and all of the following apply:

- You elected to continue the deferral of a 1998 rollover for federal purposes;
- A California return was filed for the decedent that included all of the remaining deferred income; and
- California legislation is subsequently enacted that conforms California Roth IRA provisions to federal Roth IRA provisions (as amended by the IRS Restructuring and Reform Act of 1998).

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**How to Figure Your California Adjustment**

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Because of the Roth IRA differences explained above and any California and federal basis differences\* that you may have on an IRA, you may need to make a California adjustment.

Use the worksheet on the next page to figure:

- The California basis of your traditional IRA(s);
- The taxable amount of your Roth IRA conversion distribution(s); and
- The California adjustment for the difference between the taxable distribution amount for federal and California purposes.

\*Prior to 1987, allowable IRA deductions were different under California law and federal law. Refer to FTB Pub. 1005, Pension and Annuity Guidelines, for more information.

